Sizing an industry momentum portfolio

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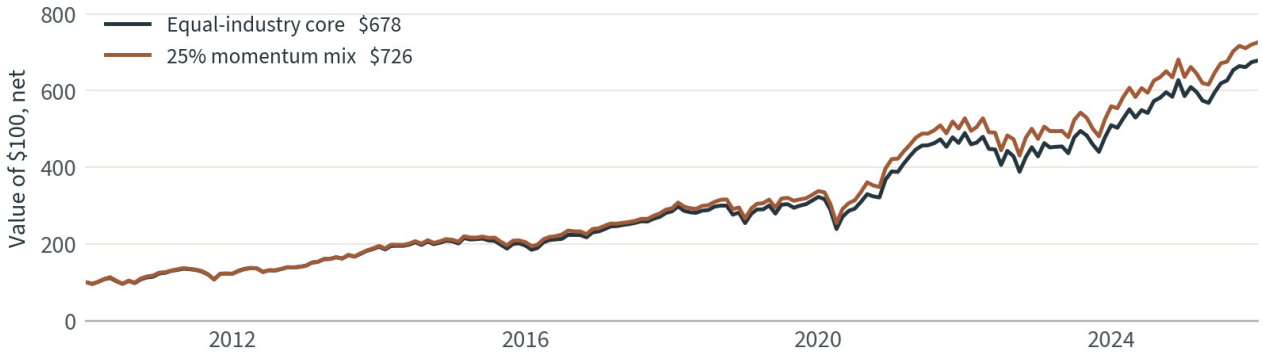
For a portfolio seeking a modest tilt towards recent winners, I would start with 25% in industry momentum and 75% in the equal-industry portfolio. The mix grew 13.19% a year after costs from 2010 to 2025. Its annual tracking error was 1.73%, roughly one quarter of the risk of moving fully into momentum.

Each month the strategy ranks 49 US industry portfolios by their compounded returns over eleven months, skipping the most recent month. The momentum portion splits its weight evenly across the ten strongest eligible industries. The rest stays equally invested across all eligible industries.[1]

How much active risk buys how much return

Momentum share	Net growth / year	Worst drawdown	Active return / year	Tracking error	Largest industry
0%	12.71%	−25.95%	0.00 pp	0.00%	2.04%
25%	**13.19%**	**−24.72%**	**0.43 pp**	**1.73%**	**4.03%**
50%	13.63%	−23.49%	0.86 pp	3.46%	6.02%
100%	14.42%	−26.19%	1.72 pp	6.92%	10.00%

Growth of $100 after trading costs



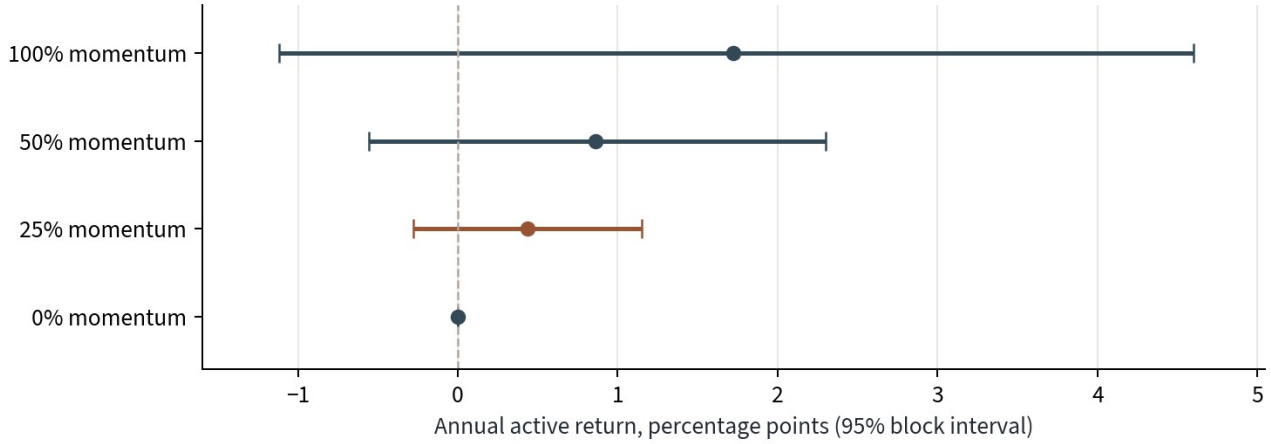
The 25% mix added 0.43 percentage points a year on an arithmetic basis. Its strongest possible target for a single industry was 4.03%, compared with 10% in pure momentum. The reported 13.19% growth compounds net monthly returns. Active return averages the monthly differences against the equal-industry portfolio.[2]

1 Kenneth R. French Data Library, 49 industry portfolios

2 George Dharma, Sizing an industry momentum portfolio, accompanying research files, Allocation desk, Sleeve results and Monthly wealth.

How much confidence to place in the result

A 95% interval for the 25% allocation's annual active return runs from −0.28 to +1.15 percentage points. Increasing the tilt widened the range as well as the estimated gain. This sample supports a sizing decision for a given risk budget, while leaving considerable uncertainty about the return advantage.



Keep model selection separate from sizing

The development period ran from 1970 to 1999. On the 2000–2009 validation period, the unbuffered top-ten rule had the higher information ratio, 0.061 versus 0.014 for a rule that retained existing holdings ranked in the top fifteen. That choice was locked before running the 2010–2025 strategy test.[3]

I then used those same 192 test months to examine the four allocation sizes. Their performance is exploratory. For the intervals, I resampled paired active returns in twelve-month blocks 5,000 times. This keeps groups of neighbouring monthly returns together and makes the breadth of plausible outcomes visible.[4]

3 George Dharma, Sizing an industry momentum portfolio, accompanying research files, Selection periods and selection lock.

4 George Dharma, Sizing an industry momentum portfolio, accompanying research files, Allocation desk, Sleeve results and Monthly wealth.

What generated the active return

The fully invested momentum portfolio gained most from its relative weights in autos, entertainment and textiles. Mining and toys detracted. These contributions reflect both the portfolio's active weight and what each industry returned while it held that weight.

Industry, full momentum allocation	Gross annual active contribution
Automobiles	+0.86 pp
Entertainment	+0.71 pp
Textiles	+0.57 pp
Precious metals	+0.53 pp
Mining	−0.42 pp
Recreation and toys	−0.38 pp

The 25% mix turned over 95% of the portfolio per year and paid about 18 bp in annual trading costs. Full momentum turned over 306% and paid 61 bp. Both calculations charge 10 bp on purchases and sales, including initial entry. Blending the two sets of weights before trading lets opposing orders cancel.[5]

The full portfolio had market exposure of 1.08 and positive stock-momentum exposure of 0.36 in the four-factor regression. Its estimated monthly alpha was −0.07%, with an interval spanning zero. The industry baskets are research portfolios, so a live fund would also need tradeable instruments and estimates for their actual spreads.[6]

5 George Dharma, Sizing an industry momentum portfolio, accompanying research files, Attribution, Cost tests and single-account rebalance.

6 Kenneth R. French Data Library, 49 industry portfolios · Kenneth R. French Data Library, US research factors and momentum